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BCS Wealth Management's Quarterly Newsletter

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Behavioral Finance & Investing

Behavioral finance is the application of psychology to understanding financial behavior and its effect on portfolios and markets. Whereas traditional economic theory assumes people always make rational choices, behavioral finance takes into consideration the cognitive, emotional, and social factors that affect people's decisions.

People view the world around them through different lenses due to their background, education, upbringing, and experiences. Over time, these lenses become hardwired into our brains. Biases are unavoidable, and if left untamed, they can lead to errors in financial decisions and other decision making.

Unless you have been living under a rock the last two years, you can probably understand how emotions and behavior can quickly change based on your surroundings and the news cycle of the day. As trusted advisors, it is important for us to be empathetic to your feelings. Yet it is equally important for us to be aware of common behavioral biases so that they don't hinder your financial goals.

So what are behavioral biases? Behavioral finance commonly identifies two categories of behavioral biases, although many of these biases interact with each other during the decision making process. These two categories are "Cognitive Biases" and "Emotional Biases."

Cognitive biases generally occur when you are presented with too much information – or information contrary to your understanding of the world. In these instances, it is natural to try to simplify things in order to make a decision or justify an opinion. Often the result is faulty thinking. Examples of cognitive biases include:

Confirmation Bias – A predisposition to seek or interpret information in a way that confirms our existing beliefs and to discount or disregard conflicting information.

Illusion of Control Bias – Overestimating our ability to control or influence the outcome of events.

Hindsight Bias – The inclination to see events as more predictable AFTER they have already occurred. Hindsight is 20/20, right?

Money, wealth, and investments are extremely emotional topics. However, when financial security is at stake, it's crucial to make decisions without letting your emotions be the main driver. Examples of emotional biases include:

Loss Aversion Bias – The tendency to emphasize avoiding a loss over seeking a gain. The pain of losses hurt more than the satisfaction of gains.

Regret Aversion Bias – Not making a decision, or being indecisive, due to fear of making the wrong decision and experiencing a bad outcome.

Status Quo Bias – The tendency to do nothing or maintain a previous decision (good or bad) unless there is a compelling case to make a change.

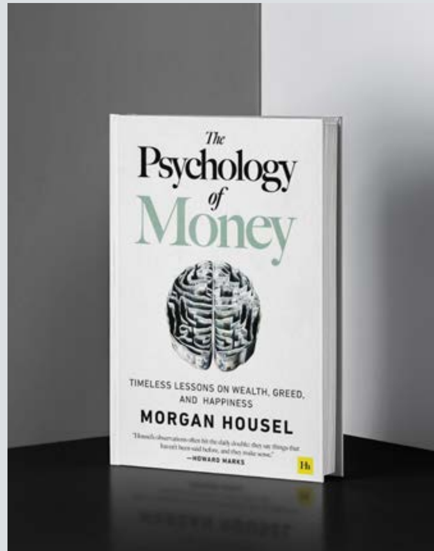
The list goes on of psychological biases that we all possess. We can't always take the emotions or past experiences out of investing. However, we can reduce the negative effects of biases by focusing on time-tested investment principles like diversification, maintaining proper allocations, rebalancing, tax efficiency, review, and communication.

Often when presented with facts outside your current frame of mind or knowledge base, a collaboration with your advisor can help produce more informed and better decisions. In a recent study by Vanguard[1], it was estimated that the impact of prudent behavioral coaching could add

150 basis points (1.5%) per year to annual returns. That adds up!

As trusted advisors, we continually educate ourselves on all aspects of financial planning. Behavioral finance is an emerging financial planning area that is crucial to successful investing in the world today. We incorporate these lessons as we work to create an investment strategy and plan that inspires confidence. Confidence in a plan helps tune out the noise of the day, look longer term, and minimize the effect of behavioral biases.

1) "Putting a value on your value: Quantifying Vanguard Advisor's Alpha" February 2019



We've touched on behavioral finance in past newsletters. We previously recommended the book The Psychology of Money *by Morgan Housel. The book explains many behavioral finance lessons in practical, relatable ways.*

Nick Clay,
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Managing Partner & Senior Financial Advisor

RIA Talent Advantage® Student Scholarship

Committed to the future of our industry

Attention Finance Majors!

Schwab Advisor Services in partnership with Charles Schwab Foundation have created the RIA Talent Advantage Student Scholarship to help remove financial barriers, advocate for diversity, and open doors for future talent within the independent Registered Investment Advisor (RIA) industry.

Scholarship details

- Awarding twelve $10,000 scholarships. Half of the scholarships will be awarded to underrepresented and diverse recipients.
- Undergraduate students:
  - Pursuing a major or minor in financial planning, or
  - Demonstrating their commitment to a career within the RIA industry.

Important dates

March 28, 2022
Student scholarship application opens

June 2, 2022
Student scholarship application deadline

July 2022
Winners notified

Learn more at https://advisorservices.schwab.com/riata-student-scholarship or by emailing RIATAscholarship@schwab.com

Quarter Review

By Nathan Goodwin

Since the Covid-inspired sell-off in the first quarter of 2020, major stock markets have generally been on an upward trend, even hitting new highs several times along the way. The U.S. stock indices finished 2021 near all-time highs. However, the first quarter of 2022 brings negative returns for practically all of the major market indices. Selling pressure came from several different angles, including the start of a rising interest rate cycle, high inflation, and Russia's invasion of Ukraine.

While this seems like a lot of negative story lines, there are also positives to take away. For example, after negative months in January and February – and the NASDAQ entering correction territory – the markets fought back in March. The DJIA, S&P 500, and NASDAQ gained 2.6%, 3.6%, and 3.4% respectively. As is typical with major events, the market overreacts then recovers. Some of the best days of the year happen on the heels of some of the worst days. The gains since mid-March could indicate that the current down market has bottomed, but there is no guarantee of this.

Major Stock Indexes	1st Quarter 2022	Year End 2021
DJIA	-4.6%	18.7%
Nasdaq Composite	-9.1%	21.4%
S&P 500	-4.9%	26.9%
Russell 2000	-7.8%	13.7%
Global Dow	-0.8%	18.6%
Japan: Nikkei 225	-3.4%	4.9%
Stoxx Europe 600	-6.5%	22.2%
UK: FTSE 100	1.8%	14.3%
Major Bond Index	**1st Quarter 2022**	**Year End 2021**
Bloomberg Barclays US Aggregate (Total Return)	-5.9%	-1.5%

I would like to break my thoughts down into three categories: what we know, what we don't know, and what we should remember.

What we know:

- We know that inflation is at a 40-year high. In February, inflation accelerated to 7.9%, the highest since the 1980s. Food and energy were the biggest contributors to this, with most other categories not far behind. Though this does put near-term pressure on equities, historically equities have been a reliable way to combat inflation.

- We know the Federal Reserve is expected to raise rates seven times this year. The first came in March with a 0.25% increase. Upon announcing this increase, the Fed indicated the likely path of increases at each of the six remaining meetings this year. The number and percentage of these increases is a delicate balancing act of trying to curb inflation while not hurting the economy.

- We know most economic numbers and corporate fundamentals are still good. Jobless claims are low, bouncing around at or below the pre-pandemic average. In March, 431,000 new jobs were added, despite fears of an economic slowdown. According to the U.S. Labor Department, the U.S. has regained 93% of the jobs lost during the beginning of the pandemic. Job openings are at record levels. Wages are increasing but not to the level of inflation. Remember, inflation and rising interest rates are typically signs of a growing economy.

What we don't know:

- We don't know with certainty the increment at which the Federal Reserve will increase rates. The Fed is not bound by 0.25% moves. If they decide a larger increase is needed, or that more increases than originally indicated are necessary, this may scare the markets.

- We don't know what will happen in the war between Russia and Ukraine. While we can estimate other factors (rising rates, inflation, etc.), this is one area where we truly have to wait and see. Investors don't like the unknown, which lends itself to volatility and rash decisions. Obviously a peaceful resolution would likely be well received by the markets, but there are simply too many possibilities to know how this will end.

What we need to remember:

- Market declines and corrections are common. Analysts at Charles Schwab recently studied intra-year returns over the last 20 years. What they found was a decline of at least 10% happened in 10 out of the 20 years, or 50% of the time. Remember, that was at least 10%. The average decline was 15%. Despite this, stocks rose most years, with only three out of the 20 years posting negative returns on the year. This is why it's important to stick to your plan and stay the course.

- Corrections and market declines create opportunities. Outside of entering a recession, corrections have proven to be good buying opportunities. Generally, high-quality companies with good fundamentals continue to be so. Therefore, look at rebalancing opportunities and adding quality investments on sale.

Though off the all-time highs of last year, the S&P 500 is still up 102% since the low in March 2020.

It's up 34% since the pre-Covid high in February 2020. So, while this was the worst quarter in two years, it's more a reflection of how good the market has been, not necessarily how bad it is now.

No one knows what the rest of the year may hold, but we do expect continued volatility. Diversification, rebalancing, and other strategies are important now like always. Having a good financial plan in place means you don't have to worry about what the market does tomorrow. Maintaining a long-term approach provides this freedom. This is the peace of mind we want you to have.

Call us with your questions and concerns. We wish you and your families a blessed spring and happy Easter. We hope to see you soon.

Nathan Goodwin, JD, CFP®
Partner & Senior Financial Advisor

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BCS Wealth Management

By John D. Brandon

401(k) Innovation & Education

As younger adults continue to enter the workforce and others get new jobs, employers are being forced to innovate the employee experience. Research suggests that planning for retirement is one of the more daunting obstacles among young professionals. Although there is a wealth of educational resources on basic retirement plan facets, like contribution amounts or differences between traditional and Roth contributions, these materials are often very general. For this reason, financial planning is one of ripest areas for potential innovation.

Younger Americans are likely to rely on their employer for financial planning. J.P. Morgan recently completed a survey of Defined Contribution plan participants. The data is broken down by age group to isolate the findings for those Americans under the age of 30 and 55 or older.

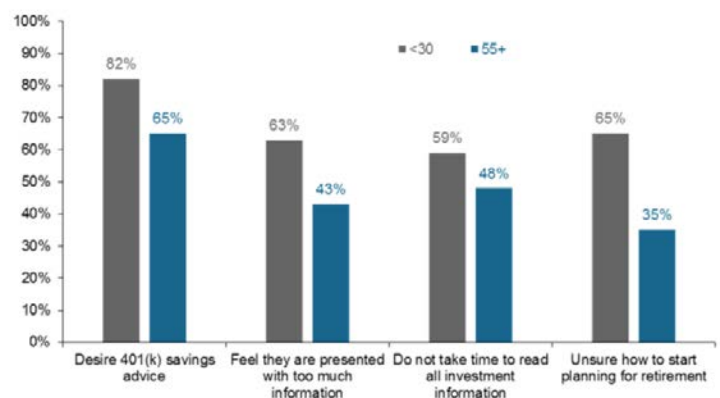
Eighty-nine percent of surveyed young participants say their employer has a responsibility to help their employees save for retirement. This includes not only a match program for 401(k)s but also an advisory component. Seventy percent believe their employer should provide financial advice and coaching for retirement. This includes information like how much should be saved, how it should be invested, and how to get back on track if one isn't doing enough for retirement.

These questions don't apply to just young folks, of course. According to the findings, both groups of participants need more education and financial advice. Over one-third of participants 55 years old and greater are not sure how to start planning for retirement, which is a concern too.

Corporate retirement plans are governed by set rules that determine the match (if there is one), vesting schedule (defines employees' tenure for ownership of the match), and many other customizable options. The Plan Documents should be reviewed annually and updated as the company and labor markets evolve.

Some companies have started retirement plans or improved their retirement plan offerings. Employers are raising their matching contributions, allowing employees to participate sooner, and loosening the rules around vesting. All of these developments can benefit the employees, and they are a sharp turn from two years ago when many companies were making cuts to their retirement plans.

Participant sentiment by age groups



Employers implementing plan features to automatically enroll and/or automatically increase employee contributions are debatable actions. However, according to J.P. Morgan's research, employees in favor of either have increased to 66% in 2021 from 52% in 2016. These automatic program efforts appear to be paying off. About two in 10 automatically enrolled participants or automatically escalated participants say they probably would not have enrolled or increased their contributions on their own. Plus, those able to take advantage of both features tend to be more confident that their savings will last a lifetime.

"How much do I need to save?" is probably the most common question I receive. Everyone is different. Years to retirement, desired lifestyle, other financial obligations, and comfort level with fluctuating account values are only a few components that dictate a financial plan. While I do not believe employers should give financial advice to employees, in fact there could be fiduciary liability associated with it, employees should have the opportunity to be educated. Our team is available for organizational support for plan review and design, as well as employee education. Don't hesitate to contact us if we can be part of your business's and employees' success.

John Brandon, AAMS®, CPFA™
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Investing Internationally – Why Bother?

By Scott Linn

Annualized Performance by Market Cycle

	1980s Jul '81-Jul '90	1990s Jul '90-Mar '01	2000s Mar '01-Dec '07	2010s Dec '07-Feb '20
U.S.	14.8%	13.8%	4.8%	7.6%
International	21.0%	4.7%	11.1%	1.1%
Difference	6.2%	9.1%	6.3%	6.5%

Source: Charles Schwab

When it comes to picking our favorite sports teams, most of us have a "home bias." We tend to support and cheer for the teams local to us. We buy their gear and spend time watching them play. If we remain loyal to our teams, it can be an emotional rollercoaster! We delight when our team wins the big game or brings home the championship, but we sulk over a hard loss or a bad season. We are up when they are up, and we are down when they are down.

While there is certainly no harm in supporting our local sports teams through thick and thin, having a home bias when it comes to investing might not allow us to achieve the most out of portfolios. A home bias in regards to investing means over-allocating toward domestic companies or completely avoiding international investments altogether. Some might be tentative about foreign investments, but they can have a positive effect to your portfolio.

According to Vanguard, the United States accounts for about 58% of the total global equity markets. While this is a significant slice of the global markets, investors are locking themselves out of over 40% of all global equities if they invest exclusively in U.S. companies. Overseas companies include household names such as Nestlé, Toyota, Honda, Sony, and Samsung among many others.

Allocating a portion of a portfolio toward foreign investments provides an element of diversification to supplement domestic investing. Investing globally gains access to a wider collection of market and economic forces than an investor can find by merely owning domestic equities. For example, performance of domestic stocks versus international stocks tends to be cyclical. While U.S. equities have recently outperformed their foreign counterparts, that has not always been the case and will likely change at some point in the future. The chart above shows the performance of the U.S. market and international markets between various economic cycle peaks.

Global investors also receive the benefit of currency diversification. Like stocks, the value of various currencies relative to each other fluctuates. In general, as the U.S. dollar increases in value relative to other currencies, the value of U.S.-based stocks increases relative to international stocks. But, this works in reverse also. As the value of the U.S. dollar decreases against other currencies, investors in international stocks tend to benefit.

While investing internationally does provide diversification, these same features can also carry unique risks including currency volatility, economic fluctuation, and political instability. Foreign stocks also tend to be more volatile than domestic equities. However, adding international exposure to an already well-diversified portfolio can actually reduce the overall volatility of that portfolio. A recent study by Vanguard showed that while the U.S. markets tend to experience the lowest volatility of any one particular country, a globally diversified portfolio of U.S. and foreign stocks experienced even less volatility over a long time horizon. The diversifying properties mentioned above help to offset the risks unique to only investing domestically or internationally.

Globally diversifying a portfolio has never been easier or more accessible. Various mutual funds and exchange-traded funds (ETFs) among other products can help an investor achieve further diversification and possibly help reduce overall volatility. Any allocation toward foreign investments should fit within your overall investment strategy and financial plan. Your financial advisor would be happy to review the appropriate international allocation for your portfolio.

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Community Involvement

The BCSWM team had an eventful quarter full of giving back. We participated in Random Acts of Kindness Week, attended the Salvation Army Souper Bowl, and read to children for Read Across America Day.

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